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April 12, 1995

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: PP Docket No. 93-253
Competitive Bidding

DOCKET FILE COPY ORIGINAL

Dear Mr. Caton:

Please find attached a copy of "Critical Financing Issues Associated With Designated Entity Participation in the Delivery of Broadband Personal Communications Services," a paper prepared by Page Call, Inc. for filing in the above-referenced docket. The submission highlights important financing issues that must be addressed by the Commission if diverse participation in Personal Communications Services is to be achieved.

Should you have any questions, please do not hesitate to call the undersigned.

Respectfully submitted,

PAGE CALL, INC.

Leonard J. Kennedy

Leonard J. Kennedy

Its Attorney

Attachment

No. of Copies rec'd 0+4
List A B C D E

CRITICAL FINANCING ISSUES ASSOCIATED WITH DESIGNATED ENTITY PARTICIPATION IN THE DELIVERY OF BROADBAND PERSONAL COMMUNICATIONS SERVICES

Prepared by

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April 12, 1995

BROADBAND PCS - WORKING PAPER FOR FCC

PROBLEM: The wireless industry's largest commercial banks have indicated that, based on current FCC rules, they will be unable to lend to companies which participate in the FCC's license installment payment plan. The lack of bank financing will significantly limit the ability of most designated entity/entrepreneurial companies to participate in the broadband PCS business.

EXPLANATION: The FCC has sought to encourage the participation of women, minorities and small businesses in PCS auctions by creating an auction "block" for them and providing bidding preferences that include, among other things, installment and interest payment plans. However, the FCC has received comments from a number of lending institutions and a "Petition for Reconsideration" has been filed explaining that the current FCC rules will not permit the banks to make loans to DE/entrepreneurial companies participating the "C Block" auction.

This is a very serious problem. The license cost will represent, at most, approximately 30% of the total cost of a broadband PCS project. Of the remaining 70%, roughly 40-50% will be for equipment and labor for construction of the network and 20-30% will fund operating losses, including interest costs associated with the installment payment plan.

If all costs related to construction and working capital had to be financed with equity, it is extremely unlikely that the DE/entrepreneurial company would be able to attract equity investors. With such a capital structure, the investor's projected return on investment would be too low to compete with alternative investments.

To offer a competitive return on investment, a relatively high-risk development project typically has a capital structure which involves 25-40% equity. With no more than 30% of capital needs "financed" by the FCC's installment payment plan for the license, this leaves 30-45% of total capital needs to be financed by other debt sources.

Traditional debt sources include the commercial banks and equipment vendors. Any prudent lender will consider the DE/entrepreneurial company's responsibility to the FCC to be debt and will include that debt in the calculation of leverage ratios. The installment payment plan and other debt can therefore co-exist within a company without creating unusually high leverage. Unfortunately, with banks unwilling to lend, vendors will be the only possible source of debt financing.

In the case of large projects, vendors will have significant incentive to help with financing. However, in smaller projects that do not offer vendors the same volumes, the economic incentive will be reduced and the same factors which are deterring the banks may also prevent vendors from taking the financial risk.

Even where vendors do prove willing to provide some financing, as the "lender of last resort", the laws of supply and demand will dictate that the cost of their financing will be high.

Thus, credit-worthy DE/entrepreneurial companies will suffer a greater-than-necessary financing disadvantage vis-a-vis their large cellular and broadband PCS competitors.

REASONS FOR THE PROBLEM: The installment payment plan (in varying forms) is available to small companies that qualify to participate in the "C Block" auction. However, the FCC's rules related to DE/entrepreneurial companies and their PCS licenses adversely affect the willingness of commercial banks to finance otherwise deserving companies.

Many of the wireless industry's largest lenders have been involved in discussions concerning the challenges presented by the FCC's current rules for DE/entrepreneurial companies. A number these banks, including NationsBank, Mellon Bank, First National Bank of Maryland and Toronto Dominion Bank, have expressed an inability to lend to DE/entrepreneurial companies participating in the C Block auction.

The banks' problems relate primarily to what would happen if a DE/entrepreneurial company got into financial distress. One of the banks' primary objectives in structuring a loan is to ensure that they can limit or manage their downside risk in such a situation. As senior lenders - those lenders with the lowest expected return, who must therefore try to achieve the lowest level of risk - the banks must have the certainty of the opportunity to workout a loan to a company that becomes financially distressed.

The FCC's problematic provisions include: no transfer of the license during the first three years; no non-DE/entrepreneurial company transfer of the license during the following two years; the FCC's right to unilaterally cancel the license in the event of non-payment; and the lack of a defined workout process for DE/entrepreneurial companies in financial distress.

At present, the FCC proposes to deal with non-payment by cancelling licenses after a 90-day grace period and re-auctioning the spectrum. The FCC would have the discretion to provide a six-month grace period to work out alternative arrangements for a defaulting licensee's financial obligation.

However, the FCC has offered no assurance as to when it might choose to invoke the discretionary workout period. DE/entrepreneurial companies and their lenders thus have no reliable assurance that - in the event of severe financial distress - they will have the ability to pursue workout options beyond the obligatory 90-day grace period, before the FCC seeks to withdraw a license authorization.

The license will constitute one of the business' most significant assets and without it all other assets of the PCS business - the customer base, the installed equipment, the office and operations space, and the trained staff - would become drains on the company and its bankers rather than sources of value.

The possibility that a license could be cancelled following a period of only 90-days will, without doubt, constrict debt financing to DE/entrepreneurial enterprises. In addition to discouraging institutional lending, the failure to develop a reasonable workout procedure may lead the FCC into a legal morass. It may also encourage DE/entrepreneurial companies experiencing financial problems and fearing the loss of their licenses to seek the protection of an early filing of voluntary bankruptcy.

AN ILLUSTRATION OF THE PROBLEM: Assume for a moment that the banks were lending to a DE/entrepreneurial company that developed severe financial problems. Based on the FCC's current provisions, the banks are concerned that the following scenarios could result:

Scenario I

- the company would be in money default of its obligations to its lenders, including the FCC
- the FCC would have the right to cancel the license after the 90-day grace period
- if the FCC did not grant a waiver, the license would be cancelled and separated from the operating assets of the PCS network
- without the license, operations would cease, depriving the network's customers of service
- customers would migrate to competitive service providers and market share previously attributable to that license and those operating assets would be lost
- the re-auction value of the license would be severely diminished by the loss of market share and the time-to-market problem involved in building a new network
- the resale value of the now non-operating assets would be minimal
- even if the buyer of the license negotiated to purchase the assets from the banks, both the FCC and the banks would be the poorer for permitting a "divide-and-conquer" approach to acquiring the business

Scenario II

- assuming that the FCC agreed not to cancel the license, this would permit the workout to proceed, with the license and the operating assets remaining together

- if the situation occurred during the first three years however, the non-transfer rule would prevent a pre-bankruptcy work-out or reorganization in bankruptcy from proceeding along the usual route of selling the business to recover as much as possible of the lenders' money

- given that the existing owners/management had been responsible for bringing the business to the edge of financial collapse, it is unlikely that they would locate investors willing to invest in the current ownership/management

- if the situation occurred during the fourth or fifth year, the "no-transfer to a non-DE/entrepreneurial company rule" would limit the search for buyers to a much smaller universe

- this could result in being unable to find a buyer with appropriate technical and management skills or of adequate financial strength to acquire a financially- and operationally-troubled company

- in either case, the no-exception restriction on transfers during the first five years could result in a final outcome similar to *Scenario I* in which the network is shut down, customers displaced, market share lost, and the ultimate value realized by the FCC and lenders greatly reduced

IMPACT OF CURRENT RULES ON DE/ENTREPRENEURIAL PARTICIPATION: The FCC's rules will deter the banks from lending to DE/entrepreneurial companies. The inaccessibility of funds and/or the unnecessarily high cost for those funds which are available will limit the ability of otherwise deserving companies to properly and competitively finance their projects.

DE/entrepreneurial companies which are aware of the financing problems and that have successfully located investors may suddenly find that these investors are unwilling to go ahead because of the expected impact on previously forecasted investor returns.

To date, many DE/entrepreneurial companies may have been too occupied with trying to line up equity financing to spend much time focussing on their ability to obtain bank financing. These companies may be mistakenly assuming that if they identify equity investors and have the installment payment plan to alleviate the costs of license acquisition, then bank financing will naturally follow.

Their investors, preoccupied with their analysis of the usual investment considerations (including the quality of management, the viability of the strategic plan, the reasonableness of the financial projections, etc.), may also assume that - based on normal lending parameters - if all of the investment considerations are right then debt financing will be readily available.

DE/entrepreneurial companies and their investors which enter the auctions unaware of the financing problem could be doomed to failure as they find themselves unable to fill in the remaining components of their capital structure. Without these critically important funds, the projects will be either unable to complete the build-out of the network, or unable to fund their operating losses. In either case, even if they are able to limp along for awhile, they will be at a significant disadvantage as compared to their deep-pocketed A and B Block and cellular competitors.

The only entities that will remain unaffected by these financing obstacles will be those DE/entrepreneurial companies backed by the major A and B Block license holders. It is expected that many A and B Block license holders will participate in the C Block auction with DE/entrepreneurial company partners in order to strategically "fill in" their license holdings. These companies will have much larger holdings over which to average the negative impact of the expected poor investor returns on C Block licenses. The strong returns on the A and B Block licenses will effectively cross-subsidize the companies' involvement in the C Block licenses.

If these crucial financing issues remain unaddressed, the FCC's installment payment plan will hurt the very companies the FCC and Congress had hoped to help. The rules will not result in increased diversity among PCS license holders. Rather, the C Block auctions will increase the concentration of PCS licenses in the hands of the larger, traditional telecommunications companies, such as the long-distance companies and the regional Bell operating companies. Deserving non-traditional participants will be unable to obtain the financing necessary to compete successfully in the PCS marketplace.

PROPOSED SOLUTIONS: A few carefully crafted modifications/clarifications to the rules should resolve the problem for the banks, while still protecting the FCC's public policy and financial concerns.

1. During the first five years, and only in a situation of severe financial distress (pre-bankruptcy workouts or reorganizations in bankruptcy), permit the transfer of a license held by a DE/entrepreneurial company along with the company's assets.

The prohibition against license transfers during the first three years prevents sham applications, encourages diversity among license holders, and avoids unjust enrichment. Likewise, the prohibition against license transfers to non-DE/entrepreneurial companies during years four and five helps assure that the FCC's objective of diversity is met for at least the first five years of the license term.

However, in a situation where the company is in default on its bank loan(s) and on its license payment obligations, the question of a sham application is a moot point and unjust enrichment is not an issue.

With respect to the issue of diversity, balance must be sought in the dynamics of (a) encouraging the participation of suitably diverse bidders; (b) helping these companies with respect to access to credit; and (c) trying to ensure that these non-traditional participants intend to be medium- to long-term players and that, within reason, they have every opportunity to stay in the industry. If one of these objectives is pursued to the exclusion of another, then the overall effort will be a failure.

The FCC's primary concern may be to accomplish specific public policy goals; banks, however, are private institutions in business for financial reasons. Just as banks must recognize the FCC's public policy concerns, so must the FCC recognize banks' fiduciary responsibility to their shareholders by providing a sound lending environment for PCS investments. A "solution" that does not respect both interests is not a viable solution.

The reality is that diversity can only be achieved on a "best efforts" basis. The further reality is that the government should be pleased that there are banks which would like to lend to credit-worthy potential DE/entrepreneurial broadband PCS license holders and which are willing to make an effort now to help the FCC modify its rules so that deserving companies can be assured the necessary access to non-FCC capital.

The most that can be asked of banks is that, to the extent possible, they try to work within the confines of the FCC's public policy concerns. It is not reasonable to expect these banks to take undue and unprecedented procedural risk, nor is it reasonable to expect that under any circumstance they be asked to take a loss in order to promote license holder diversity.

The banks have developed proposals which endeavor to provide the procedural certainty they require, while respecting the FCC's public policy objectives. These suggestions have been voiced in the original Nationsbank Petition for Reconsideration, in various bankers' meetings with the FCC staff and Commissioners, and in letters sent by the bankers to Chairman Hundt.

A procedure detailing the workout process for DE/entrepreneurial companies in financial distress must be established prior to the commencement of the C Block auction. This will permit credit-worthy DE/entrepreneurial companies to have meaningful discussions with lenders prior to the auction. As a result, at the auctions they can bid with full knowledge of their ability to access necessary capital, thus enabling them to participate aggressively in the auction.

If during the first five years, a DE/entrepreneurial company suffers a bank loan default which would give the lending banks the right to accelerate their loan (that is, begin foreclosure proceedings), the following process should apply:

Phase I

(i) if the default occurred during the first three years, the FCC would agree to grant an exception to the no-transfer rule

(ii) for a six month period, only DE/entrepreneurial buyers would be considered; this period would constitute a "DE/entrepreneurial block" purchase opportunity

Phase II

(iii) at the end of the six month period, if no offer is made which would result in a transaction that would remedy all material defaults or that would provide for the repayment of the defaulted debt, then an exception would be granted to the limited-transfer rule. The company could be offered to non-DE/entrepreneurial buyers during the following six months to salvage the banks' investments. This would permit the company to be sold, with the license intact, to any suitable buyer.

During Phase I, a potential DE/entrepreneurial buyer would benefit from a DE/entrepreneurial buying block. Even during Phase II, a DE/entrepreneurial buyer would have a competitive buying advantage, since a big company buyer would have to "pay-up" an amount equivalent to any remaining DE/entrepreneurial buying preferences.

In addition, two modifications to the banks' proposals would provide final comfort that true "best efforts" have been made to address public policy concerns:

- During Phase II, DE/entrepreneurial companies would be afforded a "right of first refusal". Thus, in the event of a non-DE/entrepreneurial offer, potential DE/entrepreneurial buyers would be given the opportunity to top the non-DE/entrepreneurial offer, effectively giving DE/entrepreneurial buyers the first and last chance to acquire the company.

- A financially distressed DE/entrepreneurial company's license could not be transferred to any of its significant (greater than 15%) minority partners. This would avoid the possibility of a big company investor in a DE/entrepreneurial company specifically creating a situation of financial distress for self-serving purposes.

These proposals "go the extra mile" in respecting the FCC's public policy objectives while also permitting the banks to deal with the practical problems involved in (a) the workout of a loan to a company in financial distress and (b) managing their responsibilities to their shareholders.

2. Permit a reorganization/work-out process which keeps the license and the assets together for a minimum pre-agreed period.

The FCC has stated that, in the event of license-holder non-payment on the installment payment plan, it may cancel the license after a 90-day grace period. The FCC must ensure payments are made on a timely basis and that it has a "big stick" to help avoid abuse of the payment plan.

Without the assurance that the license will continue to be a part of the company's assets throughout a pre-bankruptcy workout or reorganization in bankruptcy, however, the banks will not lend. They will not assume the procedural risk that the license could be separated from the operating assets before they have had a chance to work through their usual loan workout procedures.

In fact, if the FCC did not permit an orderly workout period by waiving its right to cancel the license after the 90-day grace period, a "triple lose" situation would occur. Not only would the DE/entrepreneurial company and its investors almost certainly have lost their equity investment, but - perhaps even more importantly - the network's customers (i.e. the public) would be displaced when the network is shutdown, and the license and the operating assets would lose significant value.

The banks have proposed that - in the event of severe financial distress (upon the occurrence of a bank loan default which would give the lending banks the right to accelerate their loan) - the FCC permit a traditional workout procedure to occur prior to acting on its right to cancel the license.

The banks suggest that the pre-agreed timing for a workout be a six-month period for

Phase I and a six-month period for Phase II (both "Phases" as described above). Although a one year period is much shorter than the time traditionally used by borrowers in a workout process, the banks have legal responsibilities to their borrowers that would protect DE/entrepreneurial owners from unwarranted, precipitous, arbitrary or capricious actions.

The threat of "lender liability" offers additional comfort as well. One might have some concern that a bank (perhaps due to some nefarious motivation) might act to actually encourage the financial demise of a DE/entrepreneurial company in order to allow its subsequent sale to a big company buyer. However, if the lender does not observe traditional lending practices and policies, and has no reasonable basis for deviation from established standards, the banks may be held liable for the PCS licensee's loss.

The banks' proposal tries to balance their need for an assured workout period with the FCC's ability to exercise its rights as a creditor. The FCC would retain its right to cancel the license following termination of the workout period and its usual power as a regulator to cancel licenses for other regulatory violations and to approve the transfer of licenses.

A traditionally structured bank loan would "cross-default" to a default by the license holder on its FCC installment payment plan. This means an "FCC default" would create a default in the bank loan, which, if unremedied, would usually give the banks the right to accelerate their loan. Thus, although their underlying motivations may be different, the interests of the FCC and the banks are linked.

The very serious risk of "toppling the whole house of cards" should disabuse the license holder of any consideration of frivolous non-payment on its installment payment plan. Thus, given the protections afforded by a bank's cross-default to an FCC installment payment plan default, and the risk involved in separating the license from the assets, the FCC's and the public's best interests would be met by keeping the license in place along with the assets while a workout procedure is implemented.

3. ***Enter into an agreement with the other creditors, spelling out these rights and rules.***

The FCC may not consider monies outstanding under its installment payment plan as constituting "loans" per se.

However, given that eventually as much as $2 billion may be outstanding to DE/entrepreneurial companies under this plan, as a matter of public trust, it is incumbent on the FCC to manage its installment payment program in as prudent and responsible a manner as possible.

Normal lending practice requires a company's biggest creditors (usually the banks, any pari passu lender, and any subordinated lender) to enter into an agreement which delineates the various parties' rights and obligations. Entering into such an agreement would do as much to protect the FCC's, and the public's, interests as those of the other lenders.

ADDENDUM TO

BROADBAND PCS - WORKING PAPER FOR FCC

BANKRUPTCY ISSUES: The FCC'S public policy interests are best served by providing for an orderly workout process and preventing DE/entrepreneurial companies from hastily declaring bankruptcy.

Without a better-defined approach to defaulting licensees, the FCC could wind up with the worst of policy outcomes: it will sacrifice the opportunity for diverse participation by DE/entrepreneurial companies in broadband PCS. To the extent that there is some DE/entrepreneurial participation, the FCC may also find that it has unintentionally encouraged DE/entrepreneurial companies in financial distress to seek early recourse to the bankruptcy courts.

Once in the bankruptcy court, unresolved issues of the court's power over the bankrupt's estate and the FCC's authority over licensing could threaten, or at the least delay unnecessarily, re-auction of the spectrum. These issues also could jeopardize the possible reorganization of a defaulting licensee.

Under present policies, a DE/entrepreneurial company licensee that fails to pay through the 90-day grace period must take some action or lose its entire investment. The risk, under the FCC's present policy, is not a restructuring but a virtual total loss.

In certain circumstances, banks might choose to step in to pay property taxes or similar relatively small items to help protect their loan. However, making installment payments on the license could increase the banks' exposure substantially. Banks and similar lenders are very unlikely to increase their exposure in that manner, especially if they are at the mercy of the FCC's discretionary forbearance.

Thus, a DE/entrepreneurial licensee will have an incentive to seek refuge in voluntary bankruptcy at an early stage. It is not clear that, in such a situation, the FCC could cancel a PCS authorization for default on interest or installment payments under the FCC's installment payment plan.

Once a debtor files for bankruptcy protection, the automatic stay provisions of the bankruptcy code protect the property of the debtor's estate, and prohibit all entities from pursuing any act to obtain possession of property of the bankruptcy estate. That principle may preclude the FCC, as creditor, from using license cancellation as either a debt collection tool or even simply as a means of permitting the re-auction of the spectrum.

The PCS licenses would constitute "property" of the bankruptcy estate, which is broadly defined to include all tangible and intangible personal property and causes of action.

Although the FCC has denied that any security interest exists in a license issued by the FCC, it has acknowledged in several instances that licenses can be "property," even when the holder procured the license without bidding and payment. Given that the DE/entrepreneurial company will have bid for PCS licenses and entered into arrangements with the FCC providing for interest and installment payments, the character of spectrum authorizations as "property" of the bankruptcy estate seems to be clear.

A bankruptcy court might well find that the FCC is functioning as a creditor or not in an essentially regulatory capacity - it has auctioned the license to the successful bidder in return for payment of the auction price through installment payments with interest. The fact that the DE/entrepreneurial company will not have paid all of the purchase price for the PCS license will not affect the applicability of the automatic stay under the bankruptcy laws.

The operation of the automatic stay does not depend on the debtor's having either a legal or an equitable interest in property, but applies to property that is merely in the debtor's possession at the time of the filing in bankruptcy. In this situation, the license will be in the name of the DE/entrepreneurial company and that company will have been operating under it. Thus, the company will have possessed the rights in the license to the full extent they can be possessed. It is likely that a bankruptcy court would find that the DE/entrepreneurial company has an equitable interest in the property.

The fact that the FCC is an agency of the federal government does not give rise to any apparent exemption from the automatic stay. An exemption exists for the government's enforcement of its police or regulatory power. In applying that exemption, however, the courts distinguish between exercises of police or regulatory powers to protect the public interest and the government's exercise of its pecuniary interests.

Specifically, courts do not grant exemptions from the automatic stay to a governmental unit that is attempting to obtain from the debtor money alleged to be owing to the government. Courts even have subordinated government penalty claims to the claims of general unsecured creditors. At least one court already has held that the FCC's revocation of a license does not constitute an exercise of the government's police or regulatory power. Such an action, therefore, would not be exempt from the automatic stay.

The FCC's current policy of retaining the right to near-automatic license revocation for non-paying DE/entrepreneurial companies may have a couple of different purposes. First, it may be aimed at discouraging frivolous non-payment. Second, the FCC may wish to quickly remove the license from a non-performing company and re-auction it to a better qualified company. And, third, it may hope to avoid loss of anticipated revenue by cancelling the license and quickly re-auctioning the spectrum.

If so, except in the first instance, its goals cannot be achieved. Existing law gives substantial support to the proposition that the automatic stay in bankruptcy will apply to the FCC's efforts to reclaim and resell spectrum from a defaulting DE/entrepreneurial company. If the FCC nevertheless should seek to re-auction the "recovered" spectrum, uncertainty surrounding the ultimate outcome would create risk for interested buyers and make it difficult for them to arrange the necessary financing for the project.

Moreover, once in bankruptcy essentially as a creditor claiming a right to repossess and resell the "bare" license as security for the payment of its debt, the FCC may face additional difficult issues of the application of its own past policies to its new and unaccustomed status as creditor. For instance, the FCC consistently has supported a policy prohibiting the transfer of "bare" licenses by creditors and others seeking to recover on an outstanding debt. Similarly, the FCC staff has taken the position that creditors may not take a valid security interest in an FCC license. Both the FCC and any potential bidder for the re-auctioned license probably would be subject to the bankruptcy court's injunctive powers.

In short, the FCC's current rules will encourage unnecessarily early recourse to bankruptcy. The result will not help the FCC achieve its public policy objectives and will prove costly to DE/entrepreneurial companies in financial distress.

The rules should permit DE/entrepreneurial companies an opportunity to explore alternative arrangements, prior to any revocation action, and should set forth an agreed understanding with DE/entrepreneurial companies of the FCC's "creditor" relationship, in light of the companies' hoped-for credit arrangements with other lenders.